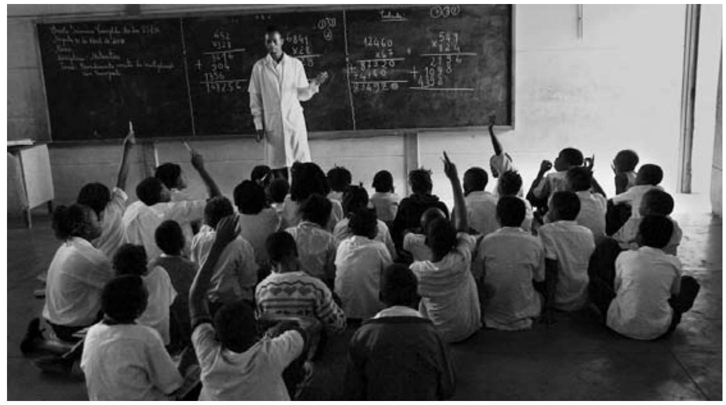
The IMF and Africa

How effective budgeting supports poverty reduction

Greater progress toward meeting global poverty goals in Africa by 2015 will require further increases in government spending on critical public services. This will often mean higher spending on public sector wages to pay the nurses, doctors, and others who are essential to providing these services. But if programs supported by the IMF restrict spending with tight deficit targets—and sometimes wage bill ceilings that limit hiring and wage increases—can progress still be made toward poverty reduction?



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The IMF is helping countries expand spending for education and health care. Pictured is a math class in Maputo, Mozambique.

Given the scarcity of resources, the answer lies in effective budgeting. There is not enough foreign exchange to pay for critical imports; aid, although sometimes large as a share of recipient-country GDP, generally remains much below needs, and below recent commitments of donor countries; and tax revenue is small relative to GDP. In addition, there are not enough skilled people to teach, cure diseases, manage spending programs, or even run private businesses.

In this difficult environment, the main responsibility of the IMF is to promote stronger macroeconomic fundamentals: notably low inflation, stable exchange rates, debt sustainability, good public financial management, and strong financial systems. These fundamentals are the prerequisite for sustained growth and poverty reduction. They help support the vibrant private sector that creates employment and raises incomes, and they provide the tax base for higher domestic revenues that can create a sustainable basis for more education and better health care.

The IMF is also adapting its policies and operations to help its member countries make difficult choices in ways that best promote growth and poverty reduction. Let's look at how this is occurring in sub-Saharan Africa.

Using aid effectively

Although Africa lags behind most other regions, progress has been made in recent years toward the achievement of the Millennium Development Goals (MDGs). With strong macroeconomic policies—often facilitated by IMF policy advice, program support, and technical assistance, and aided by financial resources from debt relief—growth over the past three years has been in the 5–6 percent range, inflation has been in the single digits, private capital inflows have been increasing, and pro-poor public spending is up. To get closer to achieving the MDGs, however, African countries need faster growth.

One way the IMF is adapting is by making stronger efforts to help countries find ways to increase their capacity to absorb aid prudently and effectively. To this end, it supports programs that allow such resources to be spent. Indeed, Fund-supported programs in Africa have been designed to allow grants to finance larger deficits when basic macroeconomic stability has been established. The Fund also helps countries manage the aid volatility that can make good public expenditure management so difficult, including by helping countries accumulate adequate reserves as a buffer against shocks.

More generally, the IMF is helping to ensure that countries have the fiscal space they need in their budgeting to expand priority social spending and public investment programs.

- ***Raising revenues.*** Tax revenues are one of the most stable and sustainable sources of financing for government spending. By providing advice and technical assistance, the IMF helps countries raise revenues efficiently and durably. The average program supported by the IMF's Poverty Reduction and Growth Facility (PRGF) in sub-Saharan Africa envisages a 2 percent increase of revenues as a share of GDP over the course of four years. The actual outturn was slightly better than this, with the average revenue share at 20 percent of GDP by the end of the program.
- ***Using grants and concessional loans.*** Foreign borrowing can provide extra resources. But if the associated investments do not pay off, debt servicing difficulties down the road can become an obstacle to growth. Countries thus need to make use of grants and concessional debt as much as possible to keep this risk as low as possible. The IMF and the World Bank have established an enhanced debt sustainability framework designed to help countries put in place debt management strategies to avoid a renewed buildup of unsustainable debt.

• ***Avoiding a debt trap.*** Borrowing from domestic sources can be a way to raise some additional revenue, but it can soak up resources that the financial system might otherwise lend to the private sector. Moreover, interest rates on such borrowing are often very high, so that even a relatively small amount of such debt leads to a large fraction of public expenditure going toward domestic debt service. For example, interest on domestic debt in Zambia reached 2.9 percent of GDP in 2004 but is expected to come down to about 1.1 percent of GDP in 2007, freeing substantial additional resources for poverty-reducing spending. The Fund helps countries strike a balance here.

On the spending side, the IMF encourages the orientation of budgets to pro-poor spending. Such spending—typically defined in a country's Poverty Reduction Strategy Paper (PRSP) to include primary education, basic health care, and country-specific priorities such as rural roads, agriculture, water, and HIV/AIDS programs—is reported by the IMF and is generally rising in PRGF countries. For example, in sub-Saharan Africa it rose a full percentage point in 2006 to 11 percent of GDP. In some cases, it may be useful to have a floor on the level in a Fund-supported program, so that in the event of shocks, such as a shortfall in expected aid, critical spending is protected from cuts. IMF-supported programs have thus in some recent cases, as in Uganda and Rwanda, included such floors.

Restricting wage bill ceilings

A recent report by the IMF's Independent Evaluation Office raised concerns about key aspects of IMF policy and practice on aid to Africa, including the use of wage bill ceilings in Fund-supported programs (see *IMF Survey,* March 19, 2007). This comes at a time when the Fund is examining the scope for removing wage bill ceilings from many of its programs in Africa. In some instances, however, these ceilings will be retained when the authorities feel stongly that they are needed to help contain serious wage bill pressures.

Because this issue has been the subject of substantial controversy over the past few years, it may be worthwhile looking at the rationale for wage bill ceilings—sometimes used in support of civil service reforms—along with the justification for working to limit their use.

Why might wage bill ceilings be useful? In many countries, the public sector wage bill has been a source of macroeconomic imbalances as a result of unplanned, excess spending and poor expenditure control. If the budget process works, there should be no need for wage bill ceilings; wage and employment increases would be in the budget and thus properly planned for and financed. When wage policy is not coordinated with sectoral priorities and the availability of money to pay for them, however, the ceiling can be a useful second line of defense. Wage bill ceilings are intended, in these circumstances, to help implement a budget that spends all available resources—and no more—and that provides for books as well as teachers and medicines as well as nurses.

Wage bill ceilings have not restricted the use of donor funds. The ceilings are set in the context of the annual budget cycle and can be revised during program reviews to incorporate new information on expected aid flows and desired staffing and wage levels. For example, the quantitative benchmark on wage bill ceilings in the program for Senegal allowed a 20 percent rise in the number of civil servants during 2003–05, in line with levels projected in the government's PRSP. Moreover, in many cases, there are "carve-outs" to accommodate additional hiring or wage increases when higher-than-expected donor funds become available. For example, Zambia's ceiling incorporated the hiring of additional health and education staff, while Malawi's ceiling adjusts automatically for donor-funded health expenditure.

Partly for these reasons, an independent survey of health practitioners in low-income countries found few constraints attributed to IMF conditionality. Asked for the most important reasons why funds remain unspent, only 1 percent of those practitioners surveyed by the Center for Global Development and the International AIDS Economics Network of health economics practitioners cited IMF or World Bank restrictions. The critical constraints reported in that survey included a lack of political will (29 percent of respondents), poor national coordination (28 percent), shortcomings in the health care delivery system (14 percent), and national absorptive capacity constraints (8 percent). The last two categories presumably partly reflect the shortage of skilled health workers and managers.

Even so, wage bill ceilings are not the best way to eliminate related macroeconomic imbalances because they do not solve the underlying problems that need to be addressed through civil service reforms and improvements in payroll management. In addition, they are often not binding but cause problems of their own instead. For example, they can create incentives to increase nonwage compensation, reducing the transparency of overall wage-related spending.

Therefore, ceilings should be selectively used in support of sound structural reforms of public sector employment and wage policy. When the budget process works well enough, the ceilings should be dropped, as recently happened in the IMF-supported program in Mozambique. ■

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For further information on wage bill ceilings and Kenya, see http://www-int.imf.org/depts/exr/exrsite/resources/resources_KenyaHealth.pdf; for Mozambique, see http://www.imf.org/external/np/vc/2006/020706.htm; and for Ghana, Zambia, Uganda, Kenya, and Malawi, see http://www-int.imf.org/depts/exr/exrsite/resources/resources_BritishMedicalAssociation%20.pdf.